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STATE FOR WHA/CAR (RBUDDEN), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

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SUBJECT: FALSE OPTIMISM? GOJ FINANCES IMPROVE IN FIRST FISCAL
QUARTER

Ref: Kingston 1559

11. Summary: Government finances for April-June 2006 (the first quarter of the Jamaican fiscal year) improved due to strong revenues and lower-than-projected capital spending. For the review period, GOJ operations generated a fiscal deficit of USD 115 million, lower than the targeted deficit of USD 154 million. However, the fiscal deficit could rise in upcoming quarters as revenues normalize and spending increases. Head of the Fiscal Policy Management Unit at the Ministry of Finance, Courtney Williams, told emboff that the first quarter result was misleading and that the fiscal position could start unraveling by the end of the second quarter. End summary.

First Quarter Results Improve

12. Central government operations for April to June 2006 generated a fiscal deficit of USD 115 million, lower than the predicted deficit of USD 154 million. The strong showing reflects a USD 38 million increase in tax on interest and a USD 27 million decline in capital expenditure relative to budget. The spike in tax on interest stemmed from the collection of taxes from pension funds, which are tax exempt. Once refunded, the flow from this source should normalize in upcoming periods. In fact, tax revenues underperformed relative to projections, reflecting the continued sluggishness of the Jamaican economy.

13. On the expenditure side, the contraction was due to the postponement of GOJ projects during the quarter. For example, the Ministry of Education did not begin to spend a USD 76 million transfer from the National Housing Trust to modernize the education system. Similarly, funds budgeted for World Cup Cricket were underutilized during the quarter, but must be exhausted by the end of the fiscal year.

Challenges Lie Ahead

14. The improvement in GOJ finances could be short-lived given the anticipated normalization in revenues and expenditures. A number of challenges are expected to emerge in upcoming quarters. First, the GOJ will not realize a projected USD 45.5 million from its proposed divestment of its 20 percent stake in the Mirant-owned Jamaica Public Service Company (an electric utility), since the company has announced that it is selling its Caribbean operations. Given the uncertainty regarding who might purchase Mirant's stake, the GOJ has decided to hold onto its shares. At the same time, negotiations are stalled over the GOJ's sale of a new cellular license, which was projected to raise USD 5.5 million.

15. Equally challenging are wage disputes with teachers, nurses, doctors, the police, and workers at the central bank. These workers remain opposed to the wage increases agreed to under a Memorandum of Understanding between trade unions and the GOJ. Head of the Fiscal Policy Unit at the Ministry of Finance, Courtney Williams, opined that a government shutdown was possible given the militant mood of these workers and their importance to the normal functioning of the country. However, if concessions are made to these groups it could lead to an unraveling of an agreement already signed with other public sector unions.

16. Comment: Fiscal performance is expected to wane for the remainder of fiscal year 2006 unless the GOJ is able to find creative ways to draw more Jamaicans into the tax net. There is little room for expenditure cuts - particularly with pending elections - and most revenue categories underperformed relative to budget during the review quarter. At the same time, relatively high prices and increased taxes continue to dampen consumer demand, which not only hurt consumption taxes, but also revenues from taxes on company profits. In fact, a recent business confidence survey pointed out that the private sector expects profits to fall in upcoming periods (reftel). Reducing expenditures to address this expected revenue shortfall is not a viable option as most spending is obligatory in nature. In fact, there could be a loosening in fiscal policy moving forward, as the current administration increases spending in preparation for the next general election. Against this background, the deficit could actually start to widen by the end of the July to September quarter of 2006. End comment.

JOHNSON